91ST CONGRESS } HOUSE OF REPRESENTATIVES { REPORT
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APPLICATION OF INVESTMENT CREDIT RECAPTURE RULE TO LEASED AIRCRAFT

DECEMBER 14, 1970.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

Mr. CORMAN, from the Committee on Ways and Means, submitted the following

REPORT

[To accompany H.R. 17988]

The Committee on Ways and Means, to whom was referred the bill (H.R. 17988) to amend section 47 of the Internal Revenue Code of 1954 to allow aircraft to be leased for temporary use outside the United States without a recapture of the investment credit, having considered the same, report favorably thereon with an amendment and recommend that the bill as amended do pass.

The amendment is as follows:

Strike out line 7, page 1, and all that follows down through page 2, line 17, and insert the following:

"(6) AIRCRAFT USED OUTSIDE THE UNITED STATES AFTER APRIL 18, 1969.—

"(A) GENERAL RULE.—Any aircraft which was new section 38 property for the taxable year in which it was placed in service and which is used outside the United States under a qualifying lease or leases shall be treated as not ceasing to be section 38 property by reason of such use until such aircraft has been so used for a period or periods exceeding 4 years in total. For purposes of the preceding sentence, the registration of such aircraft under the laws of a foreign country shall be treated as use outside the United States.

"(B) COMPUTATION OF QUALIFIED INVESTMENT.—If an aircraft described in subparagraph (A) is disposed of or otherwise ceases to be section 38 property, the increase under paragraph (1) and the adjustment under paragraph (3) shall not be greater than the increase or adjustment which would result if the qualified investment of such aircraft were based upon a useful life equal to the lesser of (i) the actual useful life of such aircraft with respect to the taxpayer, or, (ii) twice the number of full calendar months during which such aircraft was registered by the Administrator of the Federal Aviation Agency and was used in the United States, operated to and from the United States, or operated under contract with the United States. For purposes of the preceding sentence, an aircraft shall be treated as used in the United States for any calendar month beginning after such aircraft was placed in service, if such month is included in a taxable year ending before January 1, 1971, for which such aircraft was section 38 property (determined without regard to this paragraph).

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"(C) QUALIFYING LEASE DEFINED.—For purposes of subparagraph (A), the term 'qualifying lease' means a lease from an air carrier (as defined in section 101 of the Federal Aviation Act of 1958, as amended (49 U.S.C. 1301)) which complies with the provisions of the Federal Aviation Act of 1958, as amended, and the rules and regulations promulgated by the Civil Aeronautics Board thereunder, but only if such lease was executed after April 18, 1969."

SEC. 2. The amendment made by the first section of this Act shall apply to taxable years ending after April 18, 1969.

I. SUMMARY

In general, H.R. 17988 provides that there is not to be a recapture of an investment credit previously allowed with respect to an airplane by reason of the use of the airplane outside the United States, if the airplane is not used in this manner for more than one-half the time period taken into account in determining the amount of the investment credit originally allowed (that is, 4 to 6, 6 to 8, or 8 or more years). This treatment is to be available, however, only with respect to airplanes leased from U.S. air carriers after April 18, 1969, under leases which comply with the applicable Federal aviation statutes. Under present law, a previously allowed investment credit generally is recaptured if in any one taxable year the airplane is used outside the United States for more than half of the year.

This bill is reported unanimously by your committee and its enactment is not opposed by the Treasury Department.

II. REASONS FOR BILL

The amount of the 7-percent investment tax credit previously allowed to a taxpayer with respect to investment credit property when it was placed in service was determined with reference to the length of time the property would be used by the taxpayer.[1] The full 7-percent credit was allowed if the period was 8 or more years, two-thirds of a full credit was allowed if the period was 6 to 8 years, and one-third of a full credit was allowed if the period was 4 to 6 years. If property with respect to which the investment credit was previously allowed is disposed of, or ceases to be qualified investment credit property, before the end of the period (that is, in 0 to 4, in 4 to 6, or in 6 to 8 years used in determining the amount of the credit originally allowed, then the previously allowed credit is recaptured in whole or in part. The amount recaptured is the excess of the credit previously allowed over the amount of the credit which would have been allowed if it had been determined on the basis of the period of time it was actually used in the specified manner by the taxpayer.

For an airplane to qualify initially as investment credit property and to continue to qualify, it must be principally used in the United States or (if it is registered with the Federal Aviation Agency) operated either to and from the United States or under contract with the United States. This requirement has been interpreted by the Treasury Department to mean that the plane must be used in the specified manner for more than half of each taxable year. If an airplane with respect to which an investment credit was previously

[1] Although, as a result of the repeal of the investment credit, an investment credit generally is not available with respect to property acquired after Apr. 18, 1969, in some cases property acquired after that date qualifies for the investment credit by reason of one or more of the transition rules which were adopted in connection with the repeal of the credit.

allowed ceases to be used in the manner specified above for a taxable year before the end of the expected period of use, then the airplane ceases to qualify as investment credit property and the investment credit previously allowed is recaptured in whole or in part.

In recent years, U.S. air carriers have acquired (or are under binding obligations to acquire) airplanes based on a projected demand which took into account to a significant degree governmental airlift requirements, particularly those associated with Southeast Asia. Governmental airlift needs, however, have been decreasing from past levels and, as a result, a number of U.S. airlines find they have excess equipment. The only practical use of the excess airplanes at the present time, other than letting them remain idle, is to lease them on a temporary basis for use outside the United States. If this were done, however, there could be a recapture of the investment credit previously allowed with respect to the airplane.

It is possible at the present time to avoid the application of the recapture rules by rotating the individual aircraft used outside the United States so that in any 1 taxable year an airplane is used more than one-half the time in the United States. This procedure, however, generally is quite expensive and in some cases may not be possible—for example, where the airplane is leased for a temporary period of more than one-half a year to a foreign air carrier and the lease does not permit the substitution of airplanes.

Since a large part of the excess equipment which U.S. air carriers presently have (or have on order) was acquired in view of governmental needs which no longer exist, your committee does not believe it is appropriate to require U.S. air carriers, in order to preserve the investment credit they previously received with respect to the airplanes, either to let their excess planes remain idle or to go through an expensive and often impractical rotation procedure. It appears to your committee that it, in general, would be appropriate not to apply the investment credit recapture rules where an airplane is used outside the United States (under a lease which complies with Federal aviation statutes) for less than half the period taken into account in determining the amount of the investment credit previously allowed. In effect, this is applying the concept of the present Treasury regulations on the investment credit which require an airplane to be used principally in the United States during each taxable year, but over the longer period used in computing the amount of the credit allowable with respect to the airplane, instead of on a year-by-year basis. At the same time, this rule will allow aircraft to be used in a profitable and economic manner without investment credit recapture consequences.

III. EXPLANATION OF BILL

In general, the bill provides that a new airplane which qualified for the investment credit under the rules of present law for the year it was placed in service may be used outside the United States without a recapture of the credit for up to half of the period taken into account in determining the amount of the credit allowed with respect to the airplane. This provision only applies, however, if the airplane is used outside the United States under a lease from a U.S. air carrier which is made after April 18, 1969 (in general, the date of the repeal of the investment credit) and which complies with the provisions of the Federal Aviation Act of 1958 and the Civil Aeronautics Board's rules and regulations under that act.

Inasmuch as the maximum period which may be taken into account in computing the amount of an investment credit is 8 years, the bill provides that there is in all cases to be a recapture of the investment credit if an airplane is used outside the United States under the type of lease described above (or is registered under the laws of a foreign country) for more than 4 years. The amount of the credit to be recaptured in this event is to be determined under the rules described below.

As indicated above, the basic concept of your committee's bill is that an airplane may not be used outside the United States for more than half the period taken into account in determining for recapture purposes the amount of the investment credit allowable with respect to the airplane. Accordingly, the bill provides that if an airplane which is used outside the United States in the manner described above is disposed of or otherwise ceases to qualify as investment credit property before the end of the period taken into account in determining the amount of the credit originally allowed, then the amount of the investment credit to be recaptured is to be determined in the manner specified below. In computing the period of time the aircraft is considered to have been actually used by the taxpayer, the calendar months during any part of which it was used outside the United States under the type of lease described above may be taken into account only to the extent of the number of calendar months during all the days of which the plane was used in the United States (or was operated to and from the United States or under contract with the United States.) The plane also must have been registered with the Federal Aviation Agency during these months. (However, the bill provides that an aircraft (after it is placed in service) for any calendar month in a taxable year ending before 1971 is to be treated as used in the United States if the plane was qualified investment credit property under present law for that year).

The application of the recapture rule provided by the bill may be illustrated by the following example. Assume an airplane was placed in service by a U.S. air carrier in the middle of a taxable year and was used for the remaining 6 months of that taxable year and the entire following taxable year solely in the United States. Assume further that the airplane was then leased (under a lease of the type described above) for use outside the United States for a period of 3 years and was, in fact, used in that manner for the 3-year period. Assume further that at the end of the 3-year period the plane was sold by the U.S. air carrier. Although the air carrier has actually had the plane for a period of 4½ years, it is considered under the bill to have used the plane for a period of only 3 years. This results from the fact that only 1½ of the 3 years the plane was used outside the United States may be taken into account since the plane had been used in the United States for only 1½ years. Accordingly, upon the sale of the plane, there would be a recapture of the entire investment credit previously allowed with respect to it since no credit is allowed with respect to property used less than 4 years.

The amendment made by this bill is to apply to taxable years ending after April 18, 1969.

IV. CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

In compliance with clause 3 of rule XIII of the Rules of the House of Representatives, changes in existing law made by the bill, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italic, existing law in which no change is proposed is shown in roman):

SECTION 47(a) OF THE INTERNAL REVENUE CODE OF 1954

SEC. 47. CERTAIN DISPOSITIONS, ETC., OF SECTION 38 PROPERTY.

(a) GENERAL RULE.—Under regulations prescribed by the Secretary or his delegate—

(1) EARLY DISPOSITION, ETC.—If during any taxable year any property is disposed of, or otherwise ceases to be section 38 property with respect to the taxpayer, before the close of the useful life which was taken into account in computing the credit under section 38, then the tax under this chapter for such taxable year shall be increased by an amount equal to the aggregate decrease in the credits allowed under section 38 for all prior taxable years which would have resulted solely from substituting, in determining qualified investment, for such useful life the period beginning with the time such property was placed in service by the taxpayer and ending with the time such property ceased to be section 38 property.

(2) PROPERTY BECOMES PUBLIC UTILITY PROPERTY.—If during any taxable year any property taken into account in determining qualified investment becomes public utility property (within the meaning of section 46(c)(3)(B)), then the tax under this chapter for such taxable year shall be increased by an amount equal to the aggregate decrease in the credits allowed under section 38 for all prior taxable years which would have resulted solely from treating the property, for purposes of determining qualified investment, as public utility property (after giving due regard to the period before such change in use). If the application of this paragraph to any property is followed by the application of paragraph (1) to such property, proper adjustment shall be made in applying paragraph (1).

(3) CARRYBACKS AND CARRYOVERS ADJUSTED.—In the case of any cessation described in paragraph (1) or any change in use described in paragraph (2), the carrybacks and carryovers under section 46(b) shall be adjusted by reason of such cessation (or change in use).

(4) PROPERTY DESTROYED BY CASUALTY, ETC.—No increase shall be made under paragraph (1) and no adjustment shall be made under paragraph (3) in any case in which—

(A) any property is disposed of, or otherwise ceases to be section 38 property with respect to the taxpayer, on account of its destruction or damage by fire, storm, shipwreck, or other casualty, or by reason of its theft,

(B) section 38 property is placed in service by the taxpayer to replace the property described in subparagraph (A), and

(C) the reduction in basis or cost of such section 38 property described in the first sentence of section 46(c)(4) is equal to or greater than the reduction in qualified investment which (but for this paragraph) would be made by reason of the substitution required by paragraph (1) with respect to the property described in subparagraph (A).

Subparagraphs (B) and (C) shall not apply with respect to any casualty or theft occurring after April 18, 1969.

(5) CERTAIN PROPERTY REPLACED AFTER APRIL 18, 1969.—In any case in which—

(A) section 38 property is disposed of, and

(B) property which would be section 38 property but for section 49 is placed in service by the taxpayer to replace the property disposed of,

the increase under paragraph (1) and the adjustment under paragraph (3) shall not be greater than the increase or adjustment which would result if the qualified investment of the property described in subparagraph (B) (determined as if such property were section 38 property) were substituted for the qualified investment of the property disposed of (as determined under paragraph (1)). Except in the case of a disposition by reason of a casualty or theft occurring before April 19, 1969, the preceding sentence shall apply only if the section 38 property disposed of is replaced within 6 months after the date of such disposition.

(6) AIRCRAFT USED OUTSIDE THE UNITED STATES AFTER APRIL 18, 1969.—

(A) GENERAL RULE.—Any aircraft which was new section 38 property for the taxable year in which it was placed in service and which is used outside the United States under a qualifying lease or leases shall be treated as not ceasing to be section 38 property by reason of such use until such aircraft has been so used for a period or periods exceeding 4 years in total. For purposes of the preceding sentence, the registration of such aircraft under the laws of a foreign country shall be treated as use outside the United States.

(B) COMPUTATION OF QUALIFIED INVESTMENT.—If an aircraft described in subparagraph (A) is disposed of or otherwise ceases to be section 38 property, the increase under paragraph (1) and the adjustment under paragraph (3) shall not be greater than the increase or adjustment which would result if the qualified investment of such aircraft were based upon a useful life equal to the lesser of (i) the actual useful life of such aircraft with respect to the taxpayer, or, (ii) twice the number of full calendar months during which such aircraft was registered by the Administrator of the Federal Aviation Agency and was used in the United States, operated to and from the United States, or operated under contract with the United States. For purposes of the preceding sentence, an aircraft shall be treated as used in the United States for any calendar month beginning after such aircraft was placed in service, if such month is included in a taxable year ending before January 1, 1971, for which such aircraft was section 38 property (determined without regard to this paragraph).

(C) QUALIFYING LEASE DEFINED.—For purposes of subparagraph (A), the term "qualifying lease" means a lease from an air carrier (as defined in section 101 of the Federal Aviation Act of 1958, as amended (49 U.S.C. 1301)) which complies with the provisions of the Federal Aviation Act of 1958, as amended, and the rules and regulations promulgated by the Civil Aeronautics Board thereunder, but only if such lease was executed after April 18, 1969.

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